



South Carolina Retirement Systems

**Popular
Annual Financial
Report**

For the Fiscal Year Ended June 30, 2006

Pension Trust Funds of the State of South Carolina

Defining the Foundation of Your Retirement Plan

Popular Annual Financial Report

Pension Trust Funds of the State of South Carolina

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South Carolina Retirement Systems

A Division of the South Carolina Budget and Control Board

To Our Members

We are pleased to present to you our fourth annual popular report. This report is intended to provide a summary of annual financial information in an easily understandable format that supplements our more thorough *Comprehensive Annual Financial Report (CAFR)*. Data presented in this report was derived from our *CAFR*, which was prepared in accordance with Generally Accepted Accounting Principles. If you would like more information concerning our financial activities, please visit our Web site at www.retirement.sc.gov. Our *CAFR* may be viewed or downloaded from our Web site or you may obtain a printed copy by submitting a written request to our office at the address below. For any other questions or assistance, please contact Customer Services at (800) 868-9002, (803) 737-6800, or cs@retirement.sc.gov.



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Profile

South Carolina Retirement Systems

The South Carolina Retirement Systems (the Systems) administers five defined benefit pension plans that provide lifetime retirement annuities, disability benefits and death benefits to eligible members. The plans' terms specify the amount of pension benefits to be provided at a future date or after a certain period of time. The amount specified is a function of a formula based on years of service, compensation and age. The Retirement Systems also provides a defined contribution retirement plan (the State Optional Retirement Program) which is an alternative to membership in the traditional defined benefit plan. Following is a summary of the six retirement plans.

- The South Carolina Retirement System (**SCRS**) was established July 1, 1945, to provide retirement and other benefits for teachers and employees of the state and its political subdivisions.
- The State Optional Retirement Program (**State ORP**) was first established as the Optional Retirement Program for Higher Education in 1987. The State ORP is an alternative to the defined benefit SCRS plan and is now available to certain state, public school and higher education employees of the state.
- The Police Officers Retirement System (**PORS**) was established July 1, 1962, to provide retirement and other benefits to police officers and firefighters.
- The Retirement System for Members of the General Assembly of the State of South Carolina (**GARS**) was established January 1, 1966, to provide retirement and other benefits to members of the General Assembly.
- The Retirement System for Judges and Solicitors of the State of South Carolina (**JSRS**) was established July 1, 1979, to provide retirement and other benefits to State Judges and Solicitors.
- The National Guard Retirement System (**NGRS**) was established July 1, 1975, to provide supplemental retirement benefits to members who served in the South Carolina National Guard. Legislation transferred administrative responsibility of the plan from the Adjutant General's Office to the South Carolina Retirement Systems effective January 1, 2006.

Fiscal Year 2006 Highlights

Fiscal year 2006 was yet another dynamic and challenging year for the South Carolina Retirement Systems. The Systems not only continued to experience a higher workload trend due to customer demand, but also had considerable systems modifications and process changes to make in response to significant legislative changes. The State Retirement System Preservation and Investment Reform Act became effective July 1, 2005. As a part of this legislation, SCRS retirees are guaranteed to receive a pre-funded 1 percent cost-of-living adjustment (COLA) each year. Subsequent to fiscal year-end, a referendum to amend the state constitution to allow full diversification of the South Carolina Retirement Systems' investment portfolio was passed. If ratified, the amendment will permit the South Carolina Retirement System Investment Commission to invest the trust funds in a more diverse group of investments and among more asset classes, which will allow the Systems' trust funds to be on a level playing field with other public retirement funds across the nation.

State Retirement System Preservation and Investment Reform Act

The South Carolina General Assembly passed Act 153, the State Retirement System Preservation and Investment Reform Act, effective July 1, 2005. This sweeping legislation guaranteed and pre-funded a COLA for eligible SCRS retirees. If the Consumer Price Index (CPI) increases no more than 1 percent, the COLA for SCRS is equal to the percentage increase in the index. If the CPI increases by more than 1

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percent, the South Carolina Budget and Control Board is authorized to approve an additional COLA for SCRS beyond the 1 percent up to the lesser of the CPI or 4 percent. Legislation also requires that funding requirements have been met considering all unrealized investment gains and losses. The guaranteed 1 percent COLA cost SCRS more than \$2 billion; a cost which was spread among increased contributions from employers and active employees, and the requirement for retired members to make employee contributions while working for a covered employer. South Carolina's retirement plan is one of the most flexible public plans in the nation in that it allows retired members to continue receiving their annuity benefit while working. In addition, Act 153 provided death benefits to contributing working retirees. The legislation also required retired members of SCRS and PORS who either participate in the Teacher and Employee Retention Incentive (TERI) program or return to covered employment as a working retiree, to make employee contributions to the system. Active TERI participants and working retirees who retired and returned to work prior to July 1, 2005, challenged the requirement that they pay member contributions and the South Carolina Supreme Court ruled in favor of the TERI participants. However, working retirees currently have a lawsuit pending against SCRS in which they are seeking to overturn the requirement that they make employee contributions if they return to covered employment. Should the court rule against SCRS, the cost would have to be shifted to and absorbed by either employers or active employees.

Act 153 increased the SCRS employee contribution from 6.0 percent to 6.25 percent effective July 1, 2005, and from 6.25 percent to 6.5 percent effective July 1, 2006. The Act also increased SCRS employer contributions from 7.55 percent to 8.05 percent effective July 1, 2006, and included an increase to 8.55 percent becoming effective July 1, 2007. Employer contributions were further increased by an additional .51 percent to 9.06 percent to be effective July 1, 2007, to maintain SCRS' 30-year amortization period, which was jeopardized due in large part to the negative effect of a ruling by the South Carolina Supreme Court during the fiscal year, and to a lesser degree, to fund the ad hoc COLA approved by the Budget and Control Board effective July 1, 2006. The Court's ruling resulted in an estimated loss to SCRS of \$124 million in employee contributions and necessitated a shift of this funding from the TERI program participants who formerly were required to make employee contributions to employers. The Budget and Control Board increased employer contributions by the .51 percent to maintain the 30-year amortization period as required.

South Carolina Retirement System Investment Commission

In addition to the changes discussed above, Act 153 established the six-member South Carolina Retirement System Investment Commission, which is made up of financial experts, the State Treasurer and a nonvoting retired member; moved fiduciary responsibility for all investments to the Commission; provided that equity investments cannot exceed 70 percent of the total investment portfolio (formerly 40 percent); and created the position of Chief Investment Officer (CIO). This part of Act 153 was effective October 1, 2005. By statute, the CIO develops and maintains annual investment plans as approved by the Commission and, as an agent of the Commission, oversees the investment of Retirement Systems' funds. The assets of the Retirement Systems are managed externally by professional investment managers approved by the Commission. As of June 30, 2006, the Commission, which is fully responsible for the Retirement Systems' portfolio, utilized 18 outside active managers and the State Treasurer's Office to assist with equity investments and fixed income assets, respectively. The Commission is an independent agency with additional professional and administrative staff that assists in the monitoring of investment managers and in implementing the Commission's decisions.

Transfer of Administration of the South Carolina National Guard Retirement System

Effective January 1, 2006, the Systems assumed administrative responsibilities for the National Guard Retirement System (NGRS) which is a defined benefit pension plan providing supplemental benefits to National Guard members who served in South Carolina. This plan was previously administered by the Adjutant General's Office. At June 30, 2006, the plan's net assets are valued at \$12.9 million and will

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be invested in the same manner as the funds of the other four pension trust funds administered by the Retirement Systems. Contributions for the NGRS are provided by annual state appropriations based on the annual required contribution determined annually by the actuary. The legislature has made the commitment to contribute the required contributions during the fiscal year for which they are due and over time, this commitment will improve the actuarial soundness of the plan. Approximately 2,900 retired members were added to the Retirement Systems' annuitant payroll and another 5,800 active and inactive members were added to our rolls. The NGRS has been closed to new entrants since July 1, 1993; however, recent legislation reopens the system effective January 1, 2007, to any new entrants since June 30, 1993.

Project Management Officer Position Created

The South Carolina Retirement Systems hired a project management officer (PMO) to assist in meeting the division's goals in providing service to its customers. The PMO position was created as a result of the strategic planning process and will be a vital component in the determination of future strategy and planning.

Teacher and Employee Retention Incentive Program Participation Dropped

The Teacher and Employee Retention Incentive (TERI) program continued to remain attractive to our membership. The program, which was implemented in January 2001, allows retired members to accumulate deferred annuity benefits for up to 5 years while continuing employment. December 2005 marked the end of the five year deferral period for participants that joined the plan at its inception; therefore, the plan experienced a significant increase in the amount of accumulated benefits distributed this fiscal year. As a result of the distributions, the amount of assets held in trust for future payment of accrued benefits actually decreased for the first time by 24 percent, leaving a balance of \$671 million at fiscal year-end.

For the past several fiscal years, a myriad of legislation has been proposed in the South Carolina General Assembly to repeal or otherwise change the existing TERI program; however, with the exception of Act 153, these bills have been the subject of much discussion but have not been adopted by the Legislature. TERI continues to be a very controversial issue and threat of possible repeal again contributed to the large number of new participants taking advantage of TERI. Act 153, referred to earlier, did exempt all new TERI participants from state grievance rights and requires them to make employee contributions to the system while participating in the program.

Rankings Among Peer Pension Plans

The South Carolina Retirement Systems participates in an annual public pension plan benchmarking analysis conducted by Cost Effectiveness Management, Inc., (CEM). Fifty-four public pension plans participated in the 2005 CEM survey, which marked the fifth year of participation for the Retirement Systems.

Although the Retirement Systems is a customer centric organization, we are also a division of South Carolina state government and as such, must adhere to stringent budgetary guidelines. According to the CEM report, the South Carolina Retirement Systems' total adjusted administrative cost per member was \$47 in comparison to a peer median cost of \$80, the fourth lowest cost among all 54 participants. Our low administrative cost is achieved through the efficient and proactive deployment of automated systems and appropriately allocated human resources.

While the Retirement Systems has continued to provide quality services at a low cost despite brutal workload demands, we believe that we are beginning to fall behind our peers. Our infrastructure, particularly our information systems, has been stagnated by mandatory changes required by legislation and court rulings. If the Retirement Systems is to continue to provide high quality service levels, we cannot continue to do so at this pace and must expend the resources necessary to both maintain

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our infrastructure and expand our technological abilities. Doing so will allow us to divert some of our excessive workload from human to technological resources, thereby providing a more reasonable workload for our staff and the opportunity to keep up with customer needs.

Summary of Financial Condition

The funding objective of the pension trust funds is to meet future benefit obligations of retirees and beneficiaries through contributions and investment earnings. Our external consulting actuaries determine the actuarial soundness of the plans based on long term obligations and the sufficiency of current contribution levels to fund the liabilities of each plan over a reasonable time frame. Governmental accounting standards require that the maximum acceptable amortization period for the total unfunded actuarial liability is 30 years and all five defined benefit plans are considered adequately funded within GASB standards. The funded ratio for the SCRS, which represents the largest membership of the five plans, decreased from 80.3 percent to 71.6 percent. The change was due largely to plan provision changes related to legislation, which included a 1 percent guaranteed COLA, but also to a 2.4 percent ad hoc cost-of-living adjustment (COLA) that was granted effective July 1, 2005, as well as investment and non-investment related experience losses. In fact, the largest percentage of the drop in SCRS' funded ratio is attributable to the more than \$2 billion cost to guarantee and pre-fund the 1 percent COLA. As a result of these and other factors, the amortization period for SCRS' unfunded actuarial accrued liability increased from 27 to 30 years.

As of our most recent complete actuarial valuations, membership and annuitant population for our five defined benefit plans were composed of the following:

Membership and Annuitant Composition July 1, 2005

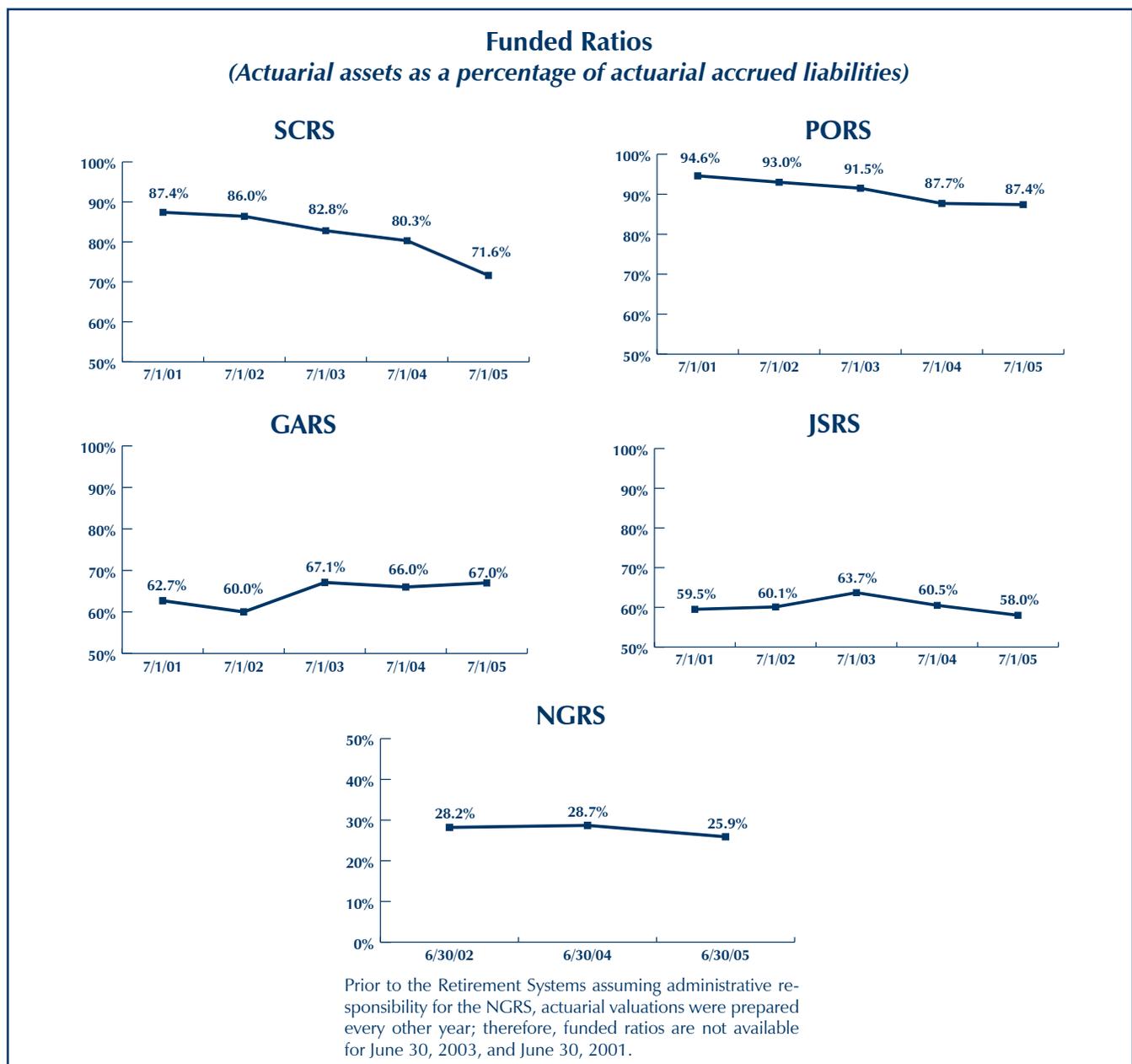
	South Carolina Retirement System	Police Officers Retirement System	General Assembly Retirement System	Judges and Solicitors Retirement System	National Guard Retirement System
Total Membership					
Active	181,022	23,795	203	128	2,864
Inactive	148,888	10,207	65	7	2,974
Retirees & Beneficiaries	94,667	9,661	312	141	2,690
Active Members					
Average Age	44	40	51	55	45
Average Years of Service	10	8	10	19	23
Average Annual Salary	\$35,110	\$35,747	\$22,543	\$120,807	N/A ¹
Annuitants and Beneficiaries					
Average Current Age	68	63	74	71	69
Average Years of Service at Retirement	23	19	20	24	27
Average AFC ² at Retirement	\$32,583	\$33,347	\$17,606	\$87,152	N/A
Average Current Annual Benefit	\$17,011	\$16,640	\$18,321	\$68,191	\$956

¹The National Guard Retirement System is non-contributory; therefore, active member salaries are not required to be reported to the Systems.

²Average Final Compensation, a component used in the formula and calculation of annuity benefits.

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Our most recent actuarial valuations confirm that your retirement plan is sound and in good condition. The five defined benefit pension plans provide guaranteed lifetime annuities to retirees and beneficiaries based on years of service and a legislatively adopted benefit formula. We judge the health of our system through actuarial valuations. Our actuarial consultants estimate our future liabilities and future assets based on a variety of assumptions commonly accepted in the actuarial industry. The actuaries then estimate what portion of our future liabilities are not yet funded and how long it will take to fund them at current rates. The greater the level of funding, the larger the ratio of actuarial assets to actuarial accrued liability (funded ratio). The funded ratios of the individual plans vary because each system is a separate plan with unique contribution and benefit levels. Changes in the funded ratios from one year to the next generally occur even though there may be adjustments to contribution rates. This is because there are numerous other variables affecting the funded ratio including, but not limited to, actuarial losses, increases in benefit payment levels, and ad hoc cost-of-living adjustments being granted. The current funded ratios of the five plans range from 25.9 percent to 87.4 percent. The chart below illustrates funded ratios over the past five years.



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To ensure the Systems' ability to properly fund the payment of retirement benefits to members in future years, it is necessary to accumulate funds on a regular and systematic basis. The principal sources from which the Systems derives revenues are employee contributions, employer contributions, and earnings on investments. In addition, annual required contributions for the NGRS are funded through an annual State appropriation. Expenses of the Systems consist primarily of payments of monthly annuities to retired members and their beneficiaries, and refunds of member contributions and interest paid upon termination. Other programs administered by the Systems include a group life insurance plan for both active and retired members, and an accidental death plan for police officers. Condensed financial statements for the fiscal year ended June 30, 2006, are presented below.

The *Statement of Plan Net Assets* presents the Plan's assets and liabilities and the resulting net assets, which are held in trust for pension benefits. This statement reflects a year-end snap shot of the Plan's investments, at market value, along with cash and short-term investments, receivables, and other assets and liabilities.

Total assets and liabilities did not change significantly from fiscal year 2004 to 2005; however, certain individual categories experienced meaningful fluctuations. The amount of cash on hand decreased not only because a larger percentage of the portfolio was classified as investments at year-end, but also because a Supreme Court ruling required a sizable amount of cash to be distributed on June 28, 2006 as refunds to certain retired members of the Teacher and Employee Retention Incentive (TERI) program whose participation began prior to July 1, 2005. This corrective distribution also prompted a related increase in other liabilities at fiscal year-end for additional contributions that were collected and refunded after June 30. SCRS also experienced a significant increase in the amount of accumulated benefits distributed this fiscal year since December 2005 marked the end of the five-year deferral period for participants who joined the TERI program at its inception. This resulted in a notable decrease in the deferred retirement benefits liability.

Plan Net Assets June 30, 2006 and 2005 (Amounts expressed in thousands)

	2006	2005	% Increase/ (Decrease)
Assets			
Cash and Cash Equivalents, Receivables and Prepaid Expenses	\$ 2,078,394	\$ 3,137,913	(33.77%)
Total Investments, at fair value	24,114,946	22,652,248	6.46%
Securities lending cash collateral invested	4,372,175	4,110,377	6.37%
Property, net of accumulated depreciation	3,696	3,814	(3.09%)
Total Assets	30,569,211	29,904,352	2.22%
Liabilities			
Deferred retirement benefits	670,527	884,776	(24.22%)
Obligations under securities lending	4,372,175	4,110,377	6.37%
Other liabilities	144,561	100,752	43.48%
Total Liabilities	5,187,263	5,095,905	1.79%
Total Net Assets	\$ 25,381,948	\$ 24,808,447	2.31%

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The *Statement of Changes in Plan Net Assets* presents information showing how the Plan's net assets held in trust for pension benefits changed during the year. This statement includes additions for contributions by members and employers and investment earnings and deductions for annuity payments, refunded contributions, group life insurance payments and administrative expenses.

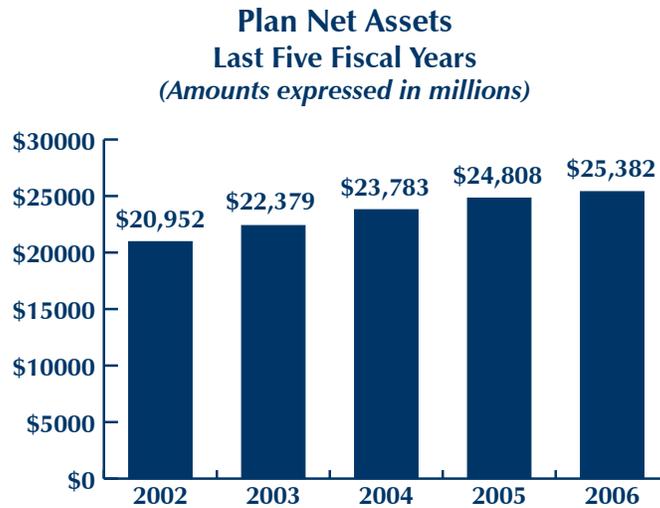
The plans' additions experienced growth in employee contributions this fiscal year primarily due to legislation that required retired members working for a covered employer to make employee contributions, but also as a result of an increase in the contribution rates paid by active SCRS and JSRS employees. Employer contributions also increased because the SCRS employer contribution rate for local governments was increased to be equivalent to the rate paid by all other participating employers. A reduction in investment income was recognized because the overall returns of our investment portfolio declined compared to the prior fiscal year. As previously referenced, as a result of the Supreme Court's negative ruling, deductions for refunded contributions increased dramatically for SCRS for the fiscal year because of corrective distributions issued to certain retired members of the TERI program. A special transfer of net assets from the State Adjutant General's Office to the Retirement Systems occurred during the fiscal year as our office assumed responsibility for administration of the National Guard Retirement System, which was previously administered by the Adjutant General's Office.

Changes in Plan Net Assets For the Years Ended June 30, 2006 and 2005 (Amounts expressed in thousands)

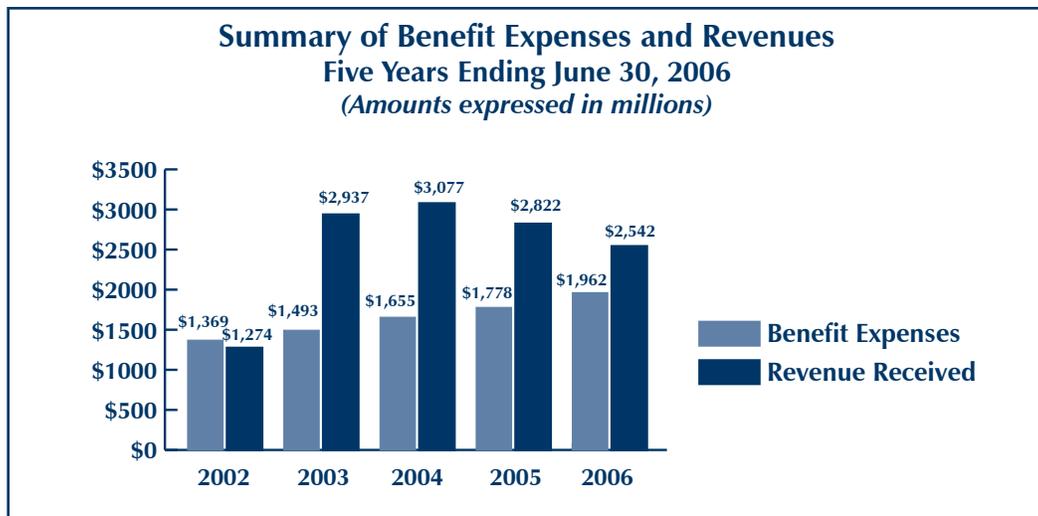
	2006	2005	% Increase/ (Decrease)
Additions			
Employee Contributions	\$ 567,908	\$ 495,012	14.73%
Employer Contributions	686,431	638,487	7.51%
Investment Income	1,282,360	1,684,122	(23.86%)
Other Income	5,399	4,188	28.92%
Total Additions	2,542,098	2,821,809	(9.91%)
Deductions			
Total Annuities	1,823,085	1,681,582	8.41%
Refunds	121,841	80,906	50.60%
Group Life	16,837	15,195	10.81%
Administrative & other expenses	20,898	18,418	13.47%
Total Deductions	1,982,661	1,796,101	10.39%
Increase (Decrease) in Net Assets before Transfer	559,437	1,025,708	(45.46%)
Transfer from State Adjutant General's Office	14,064	-	100.00%
Total Increase in Net Assets	573,501	1,025,708	(44.09%)
Beginning Net Assets	24,808,447	23,782,739	4.31%
Ending Net Assets	\$ 25,381,948	\$ 24,808,447	2.31%

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The following graph reflects Plan Net Asset values over the past five fiscal years:



The following graph represents benefit expenses paid (annuities, refunds and group life) and revenues received from all sources over the past five fiscal years:

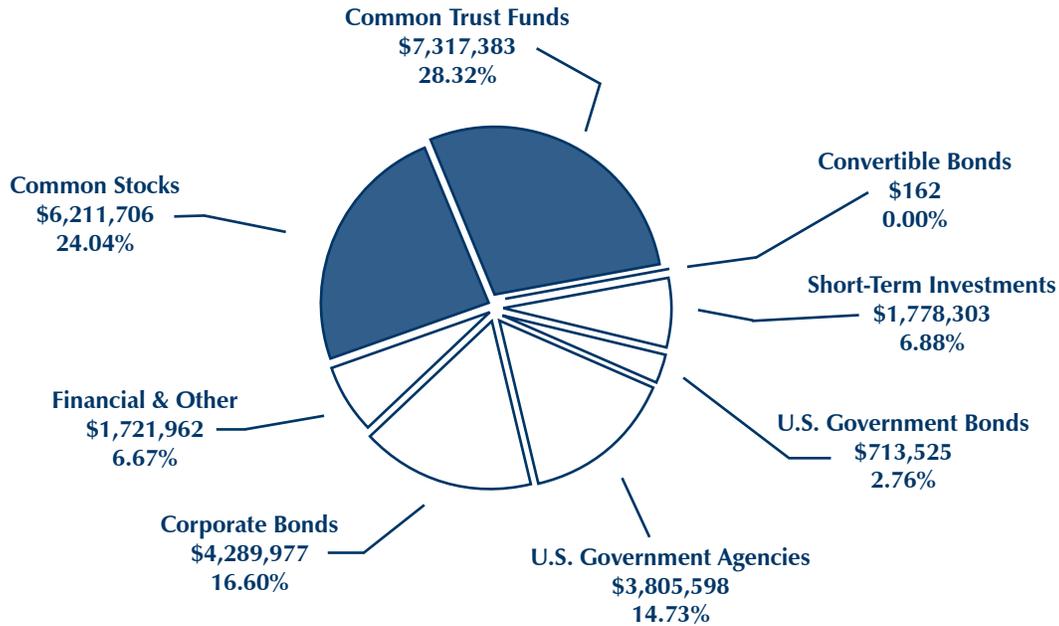


For the fiscal year ended June 30, 2006, the Systems' combined investment portfolio produced a total return of 5.13 percent. Although returns for both the fixed income and equity segments exceeded established benchmarks, due to the Systems' lack of diversification ability, actual returns lagged behind both our peers and our assumed actuarial investment return of 7.25 percent. However, during fiscal year 2006, positive structural changes were observed for the investment of Retirement System assets as a result of the State Retirement System Preservation and Investment Reform Act. The newly established South Carolina Retirement System Investment Commission is committed to using industry best practices to transform our investment program into a top ranked public pension fund. The necessary structure and tools are now in place and the diversification process will ensure critical goals are achieved, resulting in increased investment performance. The Retirement Systems' investment portfolio is now poised for significant, progressive change and opportunities, and we must be patient and persistent as efforts to increase portfolio returns are balanced with prudent management of the associated risk.

The graph on Page 9 summarizes investments held by the Systems at June 30, 2006.

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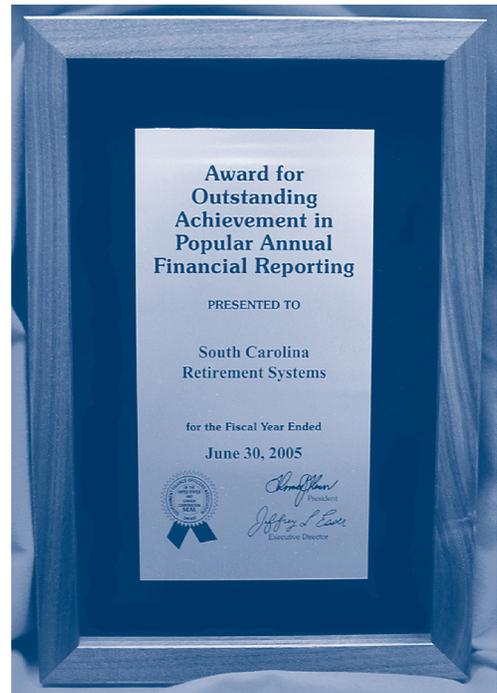
South Carolina Retirement Systems Schedule of Asset Allocation Market Value of Investments as of June 30, 2006 (Dollar amounts expressed in thousands)



The Government Finance Officers Association of the United States and Canada (GFOA) has given an Award for Outstanding Achievement in Popular Annual Financial Reporting to the South Carolina Retirement Systems for its *Popular Annual Financial Report* for the fiscal year ended June 30, 2005. The Award for Outstanding Achievement in Popular Annual Financial Reporting is a prestigious national award recognizing conformance with the highest standards for preparation of state and local government popular reports.

To receive an Award for Outstanding Achievement in Popular Annual Financial Reporting, a government unit must publish a Popular Annual Financial Report in which the content conforms to program standards of creativity, presentation, understandability, and reader appeal.

An Award for Outstanding Achievement in Popular Annual Financial Reporting is valid for a period of one year only. We believe our current report continues to conform to the Popular Annual Financial Reporting requirements and we are submitting it to GFOA.



The South Carolina Retirement Systems also received the Public Pension Coordinating Council's Public Pension Standards 2006 Award. It is the second consecutive year during which the Retirement Systems applied for and received the Council's award in recognition of meeting professional plan design and administration standards. The Public Pension Coordinating Council is a confederation of the National Association of State Retirement Administrators, the National Conference on Public Employee Retirement Systems, and the National Council on Teacher Retirement.

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